REGULATORY FLEXIBILITY COMMITTEE

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Authority: *IC 8-1-2.6-4*

MEETING MINUTES[1]

Meeting Date:	**October 10, 2001**
Meeting Time:	**10:00 A.M.**
Meeting Place:	**State House, 200 W. Washington St., House Chambers**
Meeting City:	**Indianapolis, Indiana**
Meeting Number:	**3**

Members Present: **Rep. Craig Fry, Co-Chairperson; Rep. Jack Lutz; Rep. James Atterholt; Rep. Robert Behning; Rep. David Frizzell; Rep. David Yount; Rep. David Crooks; Rep. Richard Bodiker; Rep. Susan Crosby; Rep. Ed Mahern; Rep. Scott Pelath; Sen. Greg Server, Co-Chairperson; Sen. Murray Clark; Sen. Beverly Gard; Sen. Connie Lawson; Sen. James Merritt; Sen. Becky Skillman; Sen. Timothy Lanane; Sen. James Lewis.**

Members Absent: **Rep. Daniel Dumezich; Rep. Brian Hasler; Rep. Paul Robertson;**

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[1] Exhibits and other materials referenced in these minutes can be inspected and copied in the Legislative Information Center in Room 230 of the State House in Indianapolis, Indiana. Requests for copies may be mailed to the Legislative Information Center, Legislative Services Agency, 200 West Washington Street, Indianapolis, IN 46204-2789. A fee of $0.15 per page and mailing costs will be charged for copies. These minutes are also available on the Internet at the General Assembly homepage. The URL address of the General Assembly homepage is http://www.ai.org/legislative/. No fee is charged for viewing, downloading, or printing minutes from the Internet.

Sen. Glenn Howard; Sen. Frank Mrvan; Sen. Thomas Weatherwax.

Representative Craig Fry and Senator Gregory Server, Co-Chairmen of the Regulatory Flexibility Committee, convened the meeting at 10:00 a.m. Representative Fry then invited testimony on natural gas issues.

Testimony from the Indiana Gas Association[2]

Gregory Schenkel of the Indiana Gas Association stated that he would summarize recent developments in the demand, supply, and pricing of natural gas. Before beginning his presentation, he reported generally that gas supplies are adequate and prices are lower than they were a year ago.

Mr. Schenkel introduced his organization as an association representing 14 natural gas local distribution companies (LDCs) in the state. These member LDCs serve approximately 1.7 million residential customers throughout the state. Mr. Schenkel noted that, including municipal companies, there are a total of 39 natural gas LDCs in Indiana. However, the association's members serve approximately 95% of Indiana's residential customers.

Before addressing recent developments in the industry, Mr. Schenkel provided the Committee with some background statistics on natural gas. He reported that natural gas accounts for 25% of primary energy consumption in the United States. According to a forecast by the federal Department of Energy, the demand for natural gas will increase by 40-60% from 1998 to 2020. Acknowledging statewide concerns about the effects of merchant power plants on this demand, Mr. Schenkel suggested that it is too early to determine the potential impact of such plants. However, he reminded the Committee that the State Utility Forecasting Group is currently studying the future impact of merchant plants in the region. He argued that whatever the impact, the predicted national growth in demand will require a significant amount of money to be invested in infrastructure improvements, including the expansion of pipelines. Mr. Schenkel explained that while there are ample supplies of natural gas to meet growing demand, there remain significant obstacles to accessing such supplies. He cited challenges to land access and drilling activities as examples of such obstacles.

Turning to recent pricing issues, Mr. Schenkel observed that from the late 1980s through 1999, natural gas production exceeded demand for the fuel, resulting in low prices. For example, from August 1998 to April 1999, the average price of natural gas was below $2/MMBtu. While benefitting consumers, these low prices reduced incentives to explore and drill for natural gas. However, by mid 1999, a strong economy was leading to increased demand from both the residential and commercial sectors. Recognized as a clean fuel source, natural gas was also increasingly being used to power electric generation plants. As a result of this increase in demand, prices began to climb above $2/MMBtu in May 1999. With the increase in price, came an increase in drilling and production.

Nevertheless, during the winter of 2000-2001 record cold weather caused price volatility, as supply struggled to keep pace with increased demand. Mr. Schenkel reported that the average price of natural gas was over $5/MMBtu in October 2000, with prices rising to $8-$10 in the first quarter of 2001.

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[2]See Exhibit 1.

Acknowledging the hardships faced by consumers last winter, Mr. Schenkel noted that the current pricing outlook is favorable for consumers. On October 3, 2001, the average price for gas futures contracts for the coming 12 months was about $2.80/MMBtu. This represents the lowest pricing in 2½ years. When the Indiana Utility Regulatory Commission (IURC) held a natural gas forum in July 2001, all Indiana LDCs reported adequate supply, either in storage or through contracts, for the upcoming winter. Again, Mr. Schenkel recognized that it is difficult to predict the future effect on prices of increased demand from electric generation facilities. However, he noted that the use of natural gas for electric generation is estimated to be increasing by about 6% per year.

With prices appearing to be stable, Mr. Schenkel expressed hope that consumers will not experience the price spikes they encountered last winter. However, he warned legislators that despite lower market prices for gas, consumer bills will not decrease proportionately. For example, national reports indicate that gas prices are 50% lower now than they were a year ago. At the same time, Vectren has estimated that customer bills will be 15% lower during the upcoming winter, and Citizens Gas has predicted a 10% reduction in bills. According to Mr. Schenkel, the discrepancy between market prices and billing is due to the fact that gas was expensive for both customers and gas utilities last year. While gas utilities usually emerge from the heating season without having recovered their costs, they normally are able to make up for the under-recoveries during the summer months. However, last winter's under-recoveries were so severe, that gas utilities were not able to recoup their costs over the summer. As a result, utilities will be recovering costs associated with last winter's severe situation for several months ahead. Mr. Schenkel assured the Committee that the IURC has been closely monitoring the situation. He acknowledged that the IURC has the difficult responsibility of ensuring reasonable rates for customers, while at the same time allowing gas utilities to stay economically viable.

Mr. Schenkel pointed out that another consequence of last season's severe situation is that more customers are presently in "disconnect status" than is usual. Furthermore, these disconnected customers have higher outstanding balances. Many customers were disconnected in late spring when funds from the federal Low-Income Home Energy Assistance Program (LIHEAP) were no longer available. As winter approaches, these customers are now trying to reconnect their gas service while still maintaining high outstanding balances. Mr. Schenkel noted that LIHEAP funds are not yet available, and it is not yet known how much the state will receive from the program. However, he assured the Committee that LDCs are working to get people reconnected now before severe weather arrives. Many companies have waived the fees or security deposits that are normally charged for reconnecting service.

Mr. Schenkel concluded by noting that supply and demand factors continue to shape the industry. Production is currently up in response to higher prices earlier in the year. However, demand has slowed recently as the economy has weakened. Indiana may witness reduced demand in the agricultural sector in particular. Mr. Schenkel pointed out that weather is one unpredictable factor that always influences natural gas pricing. However, he expressed hope that the National Weather Service's forecast for a "normal winter" in Indiana will mean less price volatility during the approaching heating season.

At the conclusion of Mr. Schenkel's testimony, Representative Fry reported that he had received complaints from constituents that NIPSCO has been charging high deposits to reconnect service. Mr. Schenkel indicated that he was willing to investigate the situation and help achieve a resolution.

Next, Senator Lanane asked whether LDCs are requiring customers to pay outstanding balances in full before reconnecting service. Mr. Schenkel explained that whether and to

what extent an LDC requires repayment are matters of company policy; however, such policies are subject to approval by the IURC. Mr. Schenkel indicated that instead of requiring payment in full, some LDCs are asking customers to pay what they can before reconnection.

Testimony from the Citizens Action Coalition[3]

Next, Representative Fry invited Mike Mullett of the Citizens Action Coalition (CAC) to address the Committee. Mr. Mullett told the Committee that he hoped to communicate two essential points: (1) natural gas merchant power plants should not be seen as the solution for balancing supply and demand for electricity in the future; and (2) because price volatility is inherent in the natural gas market, natural gas policies necessarily involve decisions about how to manage and assign the accompanying risks. First, Mr. Mullett stressed that natural gas merchant plants should not be used to meet the growing demand for electricity. As a premium fuel, natural gas should be reserved for priority uses, such as home heating. Mr. Mullett maintained that electricity generation is not a priority use of the fuel. While acknowledging that natural gas may play an important role in certain niche applications, such as combined heat and power applications, Mr. Mullett argued that natural gas "can't, won't and shouldn't" be used to meet baseload generating capacity.

Second, Mr. Mullett emphasized that price volatility is inherent and inevitable in the production, transmission, and distribution of natural gas. The key policy issue, he argued, is determining how to manage and assign the risk associated with such volatility. According to Mr. Mullett, the management and assignment of volatility risk are important considerations in evaluating the procurement policies of the state's natural gas utilities. Risk assignment will also be a factor in resolving the problems of overdue heating bills and disconnected gas customers. Mr. Mullett argued that customers bore a disproportionate share of the risk of price volatility last winter. Accordingly, Mr. Mullett indicated that the CAC would not support any legislation that would preclude township trustees from paying customers' past due bills.

After Mr. Mullett concluded his presentation, Representative Lutz asked whether the CAC's position on merchant plants meant that the organization was endorsing coal-fired generation. Mr. Mullett responded that energy efficiency measures should be the first response in balancing supply and demand with respect to electricity. He noted that renewable resources may also play an increased role in electricity generation. However, Mr. Mullett conceded that coal is still expected to be the primary resource for generation in Indiana in the year 2020.

Testimony from the Indiana Electric Association[4]

Turning to the issue of Indiana's electric generating capacity, Representative Fry invited testimony from the Indiana Electric Association (IEA). John Sampson, Indiana President of American Electric Power, indicated that he would deliver comments on behalf of the IEA. Mr. Sampson began by emphasizing that the nation faces different circumstances today than it did at the beginning of the twentieth century when the widespread production and use of electricity began. Acknowledging America's new involvement in an international crisis, Mr. Sampson argued that an adequate supply of electricity is now more

[3]See Exhibit 2.

[4]See Exhibit 3.

important than ever. He noted that IEA members have invested almost $10 billion in generating assets that produce more than 180,000 MW of electricity daily. Members also continue to purchase power on the competitive wholesale market. As a result, IEA members have been able to meet Indiana's electric demand while maintaining sufficient reserve margins.

Mr. Sampson further assured the Committee that the security of generation and transmission facilities is being protected. In response to the recent events of terrorism, IEA members have implemented heightened security measures around their facilities. However, Mr. Sampson stressed that there have been no specific threats to facilities.

Addressing the issue of the generation planning process, Mr. Sampson explained that utilities continually evaluate the relative merits of building new generation facilities versus buying power on the open market. When deemed necessary and appropriate, IEA members will build new facilities or collaborate in construction projects. Currently, three IEA members are building generating units.

Mr. Sampson reported that during the 1970s and 1980s, utilities relied heavily on internal generating resources and built new facilities to meet forecasted load growth. This strategy resulted in excess capacity, and the utilities were unable to recover their financial investments through the regulated rate structure. However, with the subsequent enactments of the federal Public Utility Regulatory Policy Act (PURPA) and the Energy Policy Act, the national policy shifted to promote generation provided by non-utility generators. As a result, utilities have begun to rely more on market resources, including merchant power plants, to meet incremental load growth. Mr. Sampson noted that new supplies being developed on the market have forced the State Utility Forecasting Group to change its assumptions about the need to install additional generating capacity. According to Mr. Sampson, these factors justify increased reliance by IEA members on the regional market for capacity needs.

Mr. Sampson suggested that as a result of the new role of the wholesale market in meeting capacity needs, ratepayers are now at less risk for investment decisions mandated by governmental forecasts. He maintained that a market-driven generation planning process is superior to attempts by a single company or regulator to forecast the appropriate level of generating reserves.

While arguing that the market is responding appropriately to demand by installing significant amounts of new generating capacity, Mr. Sampson conceded that the ability to trust the market must be proven over time and acknowledged the IURC's need to monitor the situation. He noted that the next Integrated Resource Plans (IRPs) submitted to the IURC will describe the portfolio of generating resources that IEA members plan to use over the next several years. In general, these portfolios are diversified between internal generating assets, consisting of baseload and peaking units, and purchases from market sources. Mr. Sampson stressed that utilities will continue to make purchases from the wholesale market when such purchases represent the cheaper alternative. Mr. Sampson assured the Committee that while IEA members do sell excess power on the market, Indiana customers receive the lower cost power and the more expensive power is sold off-system.

When Mr. Sampson concluded his remarks, Senator Server asked whether the three IEA members involved in construction projects are building baseload facilities or merchant plants. Mr. Sampson replied that the new facilities will not be merchant plants and stressed that investor-owned utilities (IOUs) are not defaulting to the wholesale market.

Next, Representative Fry asked if any IOUs are planning to build baseload plants. Mr. Sampson indicated that no IOUs in the state are planning such construction due to unfavorable market conditions.

Testimony from the Indiana Chamber of Commerce[5]

Vince Griffin, Director of Energy and Environmental Policy for the Indiana Chamber of Commerce, next spoke to the Committee about Indiana's future needs for electricity. Mr. Griffin noted that historically, Indiana has been able to attract businesses and industry because the of the state's adequate, reliable, and cost-effective supply of electricity. However, Mr. Griffin argued that Indiana currently needs a statewide policy to promote the continuation of this ample and affordable electricity supply. According to Mr. Griffin, such a policy should provide incentives to increase Indiana's baseload generating capacity.

Addressing demand and supply issues, Mr. Griffin observed that customers want electricity instantly and without restrictions. Noting that Americans have become "energy-aholics," Mr. Griffin indicated that the demand for electricity in Indiana reaches 17,000 MW during peak demand periods. Meanwhile, the state's generating capacity is 20,000 MW. While Indiana enjoyed a 30% reserve margin for power in 1985, today the reserve margin ranges from 10% to 12% and is declining. Mr. Griffin reported that the last baseload power plant in Indiana was built in the early 1980s. Meanwhile, the state's annual load growth is 1-3%. Based on its current load growth, Indiana will need an additional 7,000 MW of generating capacity by 2016. As pointed out by Mr. Griffin, Indiana will have to expand its current generating capacity by one-third in 15 years in order to meet this projected demand.

Turning to possible solutions for meeting future demand, Mr. Griffin reported that the United States has coal reserves projected to last for 300 years, while Indiana has coal reserves that could last up to 500 years. Meanwhile, worldwide there are oil and gas reserves for the next 50 to 90 years. Mr. Griffin explained that while the use of coal to produce electricity has increased three-fold since 1970, the pollutants produced from that use have decreased by 35%.

Mr. Griffin concluded his testimony by calling for leadership in developing an energy policy for Indiana. He maintained that the state's policy should advocate a diverse fuel portfolio for use in generating electricity. According to Mr. Griffin, such a portfolio should include clean coal technologies, natural gas, nuclear sources, and renewable energy sources. Additionally, the policy should encourage investment in new energy technologies such as fuel cells.

Mr. Griffin urged policymakers to assess Indiana's electric power infrastructure, including transmission and distribution capabilities. He further encouraged them to develop sensible regulatory controls that promote the responsible construction of new electric facilities. Finally, Mr. Griffin recommended support for statewide energy efficiency and conservation measures.

Citing Mr. Sampson's assertion that current market forces do not encourage utilities to build new baseload facilities, Representative Fry asked Mr. Griffin whether he considers it problematic that there are no planned baseload facilities for the state. Mr. Griffin replied that if demand for electricity grows as projected, there will be investors who are willing to finance the construction of such facilities.

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[5]See Exhibit 4.

Next, Representative Bodiker asked whether Indiana's current regulatory controls need to be changed. In response, Mr. Griffin stated that the state's utility regulations do not necessarily need to be changed. However, he suggested that changes should be made in the way regulations are applied and implemented. He cited California's streamlined process for power plant approval and permitting as an example of the efficient implementation of regulations.

Representative Crooks asked Mr. Griffin what incentives he would recommend to encourage investment in new generation capacity. Mr. Griffin suggested the use of tax abatements and other tax incentives to encourage both investment in generating facilities and the expanded use of Indiana's coal resources.

Finally, Representative Fry asked how crucial electric capacity would be in terms of future economic development in the state. Mr. Griffin noted that Indiana is a highly industrialized state, and that the types of industries in the state depend heavily on an adequate and reliable energy supply. Mr. Griffin also pointed out that if Indiana wants to develop a high-tech sector in the future, a reliable energy supply will be even more crucial.

Testimony from the Citizens Action Coalition[6]

After Mr. Griffin's presentation, Mike Mullett of the CAC returned to the podium to address electricity issues. Mr. Mullett explained that the CAC had recently partnered with other organizations to formulate a long-term energy plan for the Midwest. He noted that the plan is set forth in a report entitled *Repowering the Midwest: The Clean Energy Development Plan for the Heartland*.

Mr. Mullett indicated that the report's primary recommendation is the need for investment in end-use energy efficiency measures. He stressed that end-use energy efficiency is not the same as conservation. Explaining that demand-side management (DSM) is only a small part of end-use efficiency, Mr. Mullett described end-use efficiency as the proposition that it is economically more efficient to save electricity, in the context of end uses, than to produce electricity, regardless of the fuel source. He further reported that end-use efficiency measures could be installed for 2.5¢-2.8¢/kWh, which is less than the marginal cost of new generation. The implementation of such measures would in turn reduce demand by 30% by 2020. According to Mr. Mullett, these statistics demonstrate that both energy and money are wasted when end-use efficiency measures are not used.

A second recommendation contained in the report is the need for increased reliance on renewable resources for generation. Mr. Mullett noted that the report focuses on increased use of wind, solar, and biomass resources. Unlike traditional fossil fuels, these alternative resources are not subject to depletion. Furthermore, such resources have a less significant environmental impact than do fossil fuels. Mr. Mullett further pointed out that utilities can manage economic risk by using renewable resources as part of a diversified portfolio. Because of the value of such resources as part of a diverse energy portfolio and their relatively benign environmental impact, the report recommends that renewable resources be used for 8% of all Midwestern generation by 2010. The report advocates that this percentage increase to 22% of all generation by 2020.

Turning to the issue of new generation, Mr. Mullett predicted that emissions budgets, while often overlooked now, will necessarily play a crucial role in planning for new generation facilities in the near future. Emphasizing that NOx budgets are only the most

[6]See Exhibit 5.

immediate example of new environmental regulations, Mr. Mullett suggested that building new coal-fired facilities will not be an option in the future when additional emissions budgets are imposed. Mr. Mullettt warned that the State Utility Forecasting Group needs to consider the constraints posed by emissions budgets when it prepares its upcoming forecasts.

Mr. Mullett also predicted that future resource planning will focus on the "least cost" resource plan for the state. Mr. Mullett agreed with Mr. Sampson of the IEA that planning will shift from the presumptive course of building new generation capacity to the alternative practice of buying capacity on the market. He suggested that in individual cases, utilities will favor the practice that costs the least and that represents the most prudent business decision. He noted that the type of facility being considered–whether baseload, peaking, or cycling–will be critical in an individual utility's build-versus-purchase decision.

Finally, Mr. Mullett acknowledged the role that new technology will play in resource planning. For example, he pointed out that investing in a baseload power plant represents a "$1 billion bet" over a 40- to 50-year time frame. Given that cost and the possibility of new technologies emerging during that 40- to 50-year timeframe, utilities are increasingly viewing investments in coal-fired baseload plants as unattractive and imprudent. Similarly, the $6 billion investment required to build a 1000MW nuclear plant has become an unattractive business option for utilities. Instead, utilities are considering how they can make smaller, incremental investments designed to make their existing baseload plants more efficient.

Given the economic uncertainties that surround large-scale investments in new facilities, Mr. Mullett concluded that a "portfolio approach" that recognizes both the opportunities and limitations of the current resource base represents the best option for resource planning in the Midwest.

Representative Fry then asked Mr. Mullett whether the CAC would support building new plants in the face of an energy crisis. Mr. Mullett responded that it would depend on the type of plant. He pointed out that the CAC has supported the repowering of PSI's Noblesville plant. He also cited the CAC's support of PSEG's natural gas merchant plant in Lawrenceburg and IPL's two peaking plants as evidence that the CAC is not opposed to all plants. When asked by Representative Fry whether the CAC would ever support coal-fired plants, Mr. Mullett stated that he did not think that anyone in the state would be willing to make a $1 billion bet on such plants.

Citing Mr. Mullett's predictions about future buy-versus-build decisions, Representative Fry remarked that if utilities are going to be able to buy electricity, someone has to build the plants to produce such electricity. Mr. Mullett conceded that even if demand flattens with the implementation of end-use efficiency measures, new plants will have to be built to replace aging plants as they are retired.

Noting the role of the legislature in protecting Indiana's economic future, Representative Fry expressed concern over the recent trend of both out-of-state and foreign companies buying Indiana utilities. Stating that he shared Representative Fry's concerns, Mr. Mullett pointed out that the CAC supported recent bills to give the IURC authority over utility mergers and jurisdiction over merchant plant siting. According to Mr. Mullett, these bills recognized the state's need for more leverage in protecting Indiana from outside companies.

Acknowledging the economic disincentives to build new power plants, Representative Fry suggested that government has made new construction unprofitable by imposing

restrictive environmental regulations. Arguing that Indiana's economy is just as important as the environment, Representative Fry expressed concern that the state will not have enough power in the future. Mr. Mullett replied that he did not share that concern. He explained that utilities have been extending the lives of their existing plants. When such life extension is not feasible for a particular plant, a utility will normally retire the plant and replace it with something else. Mr. Mullett noted that utilities have even made investments to extend the life of nuclear plants by 20 years. Additionally, utilities have invested in new technologies to help meet future demand.

Senator Server asked whether Mr. Mullett was predicting that Indiana's demand for electricity would flatten as a matter of course, or whether he was predicting that demand would flatten if the state adopts certain policies. Mr. Mullett cited the report's projections of decreased demand with the implementation of end-use efficiency initiatives. Senator Server questioned these projections in light of statistics about the increased demand for electricity over the next decade due to increased computer use alone. Mr. Mullett replied that end-use efficiency measures will make it possible for computers to use less electricity in the future than they do today. He stressed that end-use efficiency does not involve conservation or a decrease in the use of computers; rather it makes the end use more efficient.

Finally, Representative Behning asked what the CAC is doing to promote energy efficiency and conservation. Mr. Mullett noted that the CAC has invested significant resources in developing the report he cited, shaping the policies of certain utilities, and employing door-to-door canvassers to encourage consumers to participate in DSM and other efficiency programs.

Testimony by the Midwest Independent Transmission System Operator[7]

Next, the Committee received testimony from Stephen Kozey. Mr. Kozey is Vice President, General Counsel, and Secretary of the Midwest Independent Transmission System Operator (MISO). Mr. Kozey introduced MISO as a newcomer to the Midwestern transmission system. He explained that MISO opened its new headquarters in Carmel in April 2001 and will begin operations on December 15, 2001. However, he noted that discussions to form the independent transmission system operator began in 1996.

When MISO begins operating, it will provide transmission service to electric utilities over a broad region, covering areas from Virginia to Manitoba and west to Iowa and Missouri. MISO will provide tariff administration, scheduling, billing and settlements, and congestion management to its member utilities. It will cooperate with the neighboring Alliance RTO to provide a "super regional" transmission rate to ensure the seamless transmission of electricity between the two service areas. MISO will also provide security coordination to address sudden, short-term transmission problems, such as when crucial plants or transmission lines suffer outages due to severe weather or other emergencies. As directed by the Federal Energy Regulatory Commission (FERC), MISO and other transmission organizations will perform market monitoring and transmission planning functions for their respective regions.

Mr. Kozey displayed a map showing the respective service territories of MISO and the Alliance RTO. He pointed out that, in contrast to states such as Wisconsin and Minnesota, Indiana does not have many areas where there are service gaps. That is, most of Indiana is served by either MISO or the Alliance. Mr. Kozey also displayed pictures of MISO's

[7]See Exhibit 6.

control room, which will contain 20 rear projection monitors depicting various portions of the transmission grid.

Mr. Kozey explained that Indiana was chosen over Wisconsin, Michigan, Kentucky, and Illinois to be the home of MISO's headquarters, largely due to economic development incentives offered by the Indiana Department of Commerce. According to Mr. Kozey, Indiana has six transmission-owning utilities that have become members of MISO. Such utilities will give monitoring and operational control of their systems to MISO. Additionally, MISO has created 90 new jobs in Indiana to date, with the total expected to reach 120 by the end of 2001.

Turning to federal developments, Mr. Kozey reported that FERC has recommended that a total of four to five regional transmission organizations (RTOs) serve the entire country. By late October, FERC is expected to issue an order establishing the number and identity of those RTOs. FERC has also stressed that independence is to be the hallmark of all RTOs in order to ensure equal access to the transmission grid.

Finally, Mr. Kozey addressed security and reliability issues. He noted that MISO serves as an added layer of security for its member utilities. MISO has a backup system known as a UPS, or uninterruptible power supply system, that triggers backup generators in the event of an outage. Furthermore, MISO's computers and communications links are doubly redundant. An independent security audit is currently being prepared and will be completed before MISO begins operations in December.

At the end of Mr. Kozey's presentation, Senator Server asked whether the current transmission system could handle increased capacity. Mr. Kozey responded that whenever large capacity growth is planned, the need for possible upgrades to the transmission system has to be considered. Before new developers come online, they typically sign a generator interconnection agreement. Such agreements specify needed transmission upgrades. According to Mr. Kozey, there is usually little disagreement as to whether upgrades are needed. Instead, disagreement tends to center on who has to pay for the upgrades.

Testimony from PSI Energy, Inc.

Douglas Esamann, President of PSI Energy, Inc., next spoke to the Committee about the state's power supply and reliability issues. He noted that in 1998, the power market experienced price spikes, mostly due to operational problems. In 1999, there were further spikes in the wholesale market due to both operational problems and a summer heat wave that led to increased demand during the peak season. More recently, prices have stabilized. Mr. Esamann attributed the decreased market volatility to new generation sources, including merchant plants, and milder weather during the summer months.

Despite the recent decrease in market volatility, Mr. Esamann noted that there are still concerns about Indiana's future electric capacity. First, the state's power reserves have decreased from a 25%-30% reserve margin in the 1980s to a present reserve margin that is roughly half of that. Second, new environmental standards regulating NOx, SO2, CO2, and mercury are forcing utilities to make substantial investments in upgrading their existing coal-fired facilities. Many utilities are choosing to retire their older coal-fired plants instead of making the costly upgrades. Mr. Esamann pointed out that such closures will reduce the state's generating capacity, unless the retired plants are replaced with other facilities.

Turning to PSI's outlook, Mr. Esamann reported that the company's capacity has been growing at a rate of about 1.5% annually. This growth represents about 80MW of new

capacity, which approximates the amount of electricity generated by the average peaking plant. PSI generates about 90% of its capacity from its own facilities and relies on market purchases for the remaining 10%. Mr. Esamann emphasized that PSI attempts to make most of its market purchases in advance to avoid expensive spot purchases during times of peak demand. He also noted that PSI has instituted programs to help reduce demand. However, he conceded that it is difficult to reduce customer demand in Indiana, where the cost of energy is relatively low.

Mr. Esamann also discussed PSI's current efforts to repower its Noblesville plant. He explained that the plant is a 50-year-old, coal-fired plant with a capacity of 90 MW. In order to address environmental concerns and increase PSI's generating capacity, the company will convert the plant into a natural gas-powered facility. The conversion will add 200MW of capacity and will reduce the thermal load on the nearby White River.

Finally, Mr. Esamann noted that PSI plans to increase its capacity in the near future mainly through the addition of gas-fired peaking plants. The company has no plans to add coal-fired baseload plants for the following reasons: (1) the sizable capital investments required for such plants; (2) the need to maintain a diverse supply portfolio; and (3) the environmental risks posed by coal-fired plants.

The Co-Chairmen adjourned the meeting at approximately 12:25 p.m.